

PN-A05-105

**REPORT ON REGULATORY ENFORCEMENT
PROCEDURES OF THE GEORGIAN NATIONAL
ENERGY REGULATORY COMMISSION**

**Georgia Power Sector Reform
Contract No. LAG-I-00-98-00005-00
Task Order No. 4**

Final Report

Prepared for:

U.S Agency for International Development
Bureau for Europe and NIS
Office of Environment, Energy and Urban Development
Energy and Infrastructure Division

Prepared by:

Hagler Bailly
1530 Wilson Boulevard
Suite 400
Arlington, VA 22209-2406
(703) 351-0300

October 22, 1999

A

- 1 -

REPORT ON REGULATORY ENFORCEMENT PROCEDURES OF THE GEORGIA NATIONAL ENERGY REGULATORY COMMISSION

Introduction

This report assesses the Georgian National Energy Regulatory Commission's (GNERC's) enforcement procedures. We reviewed and analyzed relevant laws and other authorities to determine the extent to which the Commission may enforce relevant laws and regulatory decisions, and what actions it may undertake to penalize violators. The report identifies and evaluates problems that GNERC may encounter in pursuing a program of enforcement. Finally, we make recommendations that may further strengthen the enforcement process.

What should be kept in mind regarding this assessment is that the Georgian legal system is going through a transition and reform period during which existing laws are being gradually updated and new regulations are in the process of adoption. In months to come there may be substantial changes in Georgian laws which could affect regulatory authorities and procedures. Therefore, this report should be viewed as a document describing the status of the enforcement procedures as of the date of its publication.

Existing Legal Authorities

Georgian Law on Electricity and Natural Gas (May 21, 1999)

The Georgian Law on Electricity and Natural Gas, prior to the 1999 amendments the Georgian Electricity Law of 1997, defines in general terms the legal bases for the Commission's operation. Clause 4, paragraph 2, it specifies:

The legal base for Commission's activities is the Georgian Constitution, International Treaties, the Present Law, the Charter of the Commission, and other Legal Regulations.

Clause 14 further specifies:

The Commission, in accordance with the legislation, is authorized to hold liable all legal entities or individuals who violate the provisions of this law or resolutions and decisions made by the Commission.

Any decision made by the Commission can be appealed, as provided in Clause 15:

A resolution and decision made by the Commission may be appealed, by affected person, to the Constitutional or Supreme Court of Georgia, in accordance with the existing rules and procedures.

With regard to licenses, the Commission:

Shall . . . be entitled to monitor fulfillment of the License requirements by the Licensees" (Clause 24, paragraph 1),

because

electricity generation, transmission, dispatch, distribution, import and export as well as natural gas supply, transportation and distribution without the relevant license shall be forbidden (Clause 24, paragraph 2)

Clause 25 of the Electricity Law requires that:

The Commission shall establish procedures necessary to implement requirements of the present Law.

In case of a Licensee's non-compliance with the Commission's regulatory requirements the Commission may modify, suspend or revoke a license without the prior consent of the Licensee, and may require the Licensee to comply with different, or more stringent requirements than the requirements included in the initial License (Clause 31).

Charter of the Commission (October 6, 1997)

The Charter of the Commission has a limited number of provisions regarding regulatory enforcement. Among these provisions are the following mandates:

To consider cases of violation of the legislation on electricity and to make relevant decisions within its jurisdiction. (Paragraph 3.3)

To monitor implementation of license provisions and to penalize for violations according to the Law. (Paragraph 3.5)

Within its competency, according to the interests of the sector, issue resolutions which are mandatory for the licensees and the customers. (Paragraph 4.2)

To suspend or revoke the license terms in case of violation of the legislation on electricity or conditions of licensing. (Paragraph 4.10)

Regulation of the Commission (October 6, 1997)

In its regulations, GNERC states as follows respecting enforcement:

At the session shall be considered issues related to licensing, tariff setting, resolution of disputes regarding electric power sector and cases related to the violation of the legislation, as well as other issues being in the competency of the Commission. (Paragraph 2.4)

Rules of control of implementation of legal regulations and tasks of the Commission are determined by internal operational rules. (Paragraph 5.2)

Interim Licenses (1997-1999)

To date the Commission has issued four types of interim licenses: generation, dispatch, transmission, and distribution. The licenses are valid for a period of two years, after which the licensees have to apply for a permanent license, subject to periodic Commission review. Currently, the interim licenses contain only a single reference to a licensee's compliance with the license terms:

Revocation or suspension of a[n] . . . Interim License shall be conducted by the Commission for violation of its terms and conditions. (Terms of Interim Licenses, Paragraph 4)

The Interim Licenses give the Commission the authority to control the licensee's compliance with the license terms:

The Commission shall conduct the supervision over fulfillment of the conditions and requirements of the Interim License. (Terms of Interim Licenses, Paragraph 9)

Rules and Terms of Issuing Interim Licenses (November 5, 1997)

In its Rules and Terms of Issuing Interim Licenses, issued in the fall of 1997, the Commission included a provision similar to those in the interim licenses, but with additional language:

The Commission shall have the right to establish procedures of modifying, extension or revocation of licenses¹. If the Commission believes that such modification or revocation is necessary, the Commission shall notify the Ministry and the Licensee in advance so they might attend the meeting of the Commission. (Paragraph 3.2)

GNERC's interim licensing rules also provide:

The Commission shall have a right, acting by decision, to extend, modify or revoke a license with the purpose of reorganization and promotion of transit of the electricity sector to market principles. The license may be modified or revoked by the Commission before the expiration of its terms and without interruption of functioning of the enterprise. (Paragraph 3.5)

Permanent Licenses (1999)

Currently, the Commission is in the process of issuing permanent licenses for generation, dispatch, transmission and distribution licenses. In comparison with the interim predecessors, the permanent licenses have more provisions regarding regulatory enforcement. In order of their appearance in the text of a standard license they are:

The Commission shall supervise and control compliance of the . . . licensee with the rules and conditions of the license. If necessary, the Commission modifies, suspends or revokes the license. (General Provisions, Paragraph 3)

Georgian legislation prohibits unlicensed activities in the electricity . . . sphere and such activity is considered as illegal action. Administrative, civil and criminal codes of Georgia consider sanctions which can be applied to the violator of the Law. (General Provisions, Paragraph 4)

The licensee shall act in accordance with the legislation of Georgia, rules and conditions of the . . . license, requirements stated in the Appendix to

¹ The Commission has not yet promulgated such regulations.

the . . . license, regulations and decisions issued by the Commission.”
(Obligations of the Licensee, Paragraph 1 (a))

The permanent licenses further authorize the Commission to:

- a.) Raise the issue of modification, suspension or revocation of a license in accordance with the established rules, if the . . . licensee fails to meet the conditions and rules set in the license;
- b.) Suspend or revoke a license without warning, if the activity of the . . . licensee causes danger to human life and health or to energy facilities;
- c.) After the suspension or revocation of a license the commission may reconsider the issue of renewing the license, if the . . . licensee is in compliance with the license conditions and rules. (Modification, Suspension, Revocation and Renewal of a License, Paragraph 1)

The permanent licenses also provide,

The Commission and its authorized members . . . have a right to ask for and receive any documents connected with the activity of the licensee.
(Supervision over the Licensed Activity, Paragraph 1)

The Commission has a right to supervise the fulfillment of conditions and rules defined in the license as well as supervise and control licensee’s activity and accounting. (Supervision over the Licensed Activity, Paragraph 2)

Code of Administrative Violations (1984)

At present, the Georgian Code of Administrative Violations seems to be the only law that addresses the imposition of monetary penalties on the violators of regulatory acts. Parliament updated the Code in 1997 to account for the then newly-created Commission. The text specifically addressing the violations in the energy sector that may involve the Commission is presented in the attachment to this report. The most important provision appears to be Clause 92 (Violations of requirements set by the Commission):

Noncompliance of the licensee of the energy sector or the customer with the regulations set by the Commission shall be penalized by the amount of minimum salary² multiplied by 30 to 300.”³

Analysis

Comprehensiveness and Consistency of Existing Legal Authorities

This summary of excerpts from various legal sources shows that the Commission has considerable authority to enforce the terms of the licenses and regulations that it issues. Although it seems fairly clear that the Commission has the authority to make decisions and expect licensees to comply with them, the Commission believes that additional clarification is needed as to whether or not the Commission’s decisions will be regarded at the same level as the decisions of common courts. It is their expectation that the ongoing reform of the legal system will address this issue.

In many instances the statements in existing laws refer to “appropriate procedures” or “appropriate laws and regulations”. The problem is that laws and regulations setting forth such procedures do not exist at this time. According to the Commission⁴ many of the relevant legal documents are either in the process of registration at the Ministry of Justice⁵ or about to be created by the Commission. Until, however, the appropriate procedures and regulations have been issued, references to specific procedures are ineffective and without a substance. In addition, the Commission believes that existing legal language does not give it the authority to be the ultimate decision-maker with regard to enforcement.

² As of the date of this report the minimum monthly salary in Georgia was at the level of 20 Lari (Presidential Decree No. 351 issued on June 4, 1999), or, at the rate of exchange prevailing as of the date of this report, approximately \$11. The suggested range of fines would thus be from 600-6,000 Lari, or approximately \$325-\$3,250.

³ Originally, this Clause included the phrase: “*Noncompliance of the licensee or the customer with the regulations set by the Commission that adversely affect other licensee of the energy sector or customer shall be...*”, which would severely have constrained GNERC’s ability to enforce its regulations.

⁴ Meetings and telephone inquiries conducted between August 2 and August 13, 1999.

⁵ Under the Civil Code, registration of GNERC decisions with the Ministry of Justice is a prerequisite to their legal effectiveness.

It is in the Commission's interest to proceed with the internal rulemaking as soon as possible so that further delay can be avoided should the reform of the legal system progress as scheduled. Working closer with the legislative body and other agencies and ministries may benefit the Commission in the long run and increase the understanding and awareness of the required regulatory and legal process. As examples, the Commission should prepare the following procedures in order to make the entire enforcement process more efficient and effective:

- Procedures for dispute resolution between the entities in the energy sector
- Procedures for handling complaints from the entities in the energy sector
- Procedures for periodic and ad hoc reviews and audits of all types of activities conducted by the regulated entities
- Procedures for conducting open meetings and releasing information to the public and the press
- Procedures for professional and ethical conduct for the Commissioners and the employees of the Commission

Monetary Penalties

Under the Code of Administrative Violations, the Commission is limited to preparing a protocol on violations and submitting it to the proper authorities. The level of monetary penalties, if any, will then be established by those authorities. Such an approach dilutes the Commission's authority.

Inability of the Commission directly to impose the monetary penalty on the violators. The Commission's role is effectively limited to that of a party that merely prepares the paperwork and forwards it to the appropriate authorities. The Commission must, under this procedure, spend considerable amount of time and effort conducting the initial investigation of the case. However, the pace at which each case is subsequently handled will not depend on the Commission. The authorities may not have sufficient expertise, not to mention the resources, to dispose of the case in a timely and proper fashion. It is quite possible that the Commission staff will be called to assist the courts, which may further delay the case and tie up the Commission's resources. The uncertainty of the legal process will discourage Commission involvement in the enforcement process.

Inadequacy of monetary penalties. As discussed above, the monetary penalties are not that high, especially for utilities with considerable financial resources. Currently, only penalties for

damage to electric network are differentiated between residential and corporate violators and can be substantial for individuals. The fines for regulatory non-compliance will most likely fall on the shoulders of the entire enterprise rather than responsible individuals. Possible violators may include the amount of “most likely” penalty in assessing the risk involved with the violation and simply consider it as a cost of doing business. The regulatory/legal lag may further enhance this type of behavior.

Refusals to pay. Another possible scenario is one in which the violator simply refuses to pay the fine. Despite the fact that it is illegal to operate without a license approximately a dozen entities in Georgia operate without licenses, and consequently knowingly violate this part of the Law on Electricity and Natural Gas. Even those entities that received licenses and, as part of the licensing conditions, are obligated to make either lump sum or periodic payments, quite often fall behind the agreed payment schedule. That fact alone could be used by the Commission as a basis for imposition of penalties or suspension of the license. So far, the Commission has not pursued any known suspects of either of these types of violations,⁶ despite the fact that the budget of the Commission is license-fee based.

Compliance with license terms and conditions

Feasibility of license cancellation. Suspension or revocation of a license seems to be the ultimate penalty, requiring a licensee temporary or permanently to cease operations. In practice, however, the result may be quite different. The first prerequisite to suspension or revocation is the willingness and the courage of the Commission to make such a major move against the licensee. The next step is to secure uninterrupted service to the customers while a replacement is found. At this step the situation becomes complicated, because:

- The former licensee cannot operate without a license, because unlicensed operation is illegal by law
- The Commission should suspend or revoke a license only if it has made provision for continued operation of the enterprise, but no rules regarding establishing a temporary receivership have been created.
- A new licensee or new management with adequate and proven experience must be found.

⁶ The Commission attempted to resolve the licensing and payment problem by asking local authorities to exert pressure on the violators in their respective regions. For a number of reasons, however, this approach proved ineffective.

The lack of policy specifying what happens after the license is suspended or revoked will contribute to the overall confusion. In the absence of other reliable system operators or investors in the power market, finding an adequate replacement may be next to impossible. Ultimately, it may be more effective for the Commission simply to ignore violations and move on. The Commission is currently interested in pursuing the correction of that apparent gap in legal acts.

Suggestions for Commission Actions Regarding Enforcement

As noted above, GNERC can and should adopt regulations respecting such matters as dispute resolution, complaints, and reviews and audits of licensee compliance. We make the following additional recommendations respecting GNERC's enhancement of its enforcement authority. These suggestions involve actions strictly within the Commission's jurisdiction, and may be undertaken by the Commission without delay.

Rate of Return Adjustments. A common approach in dealing with non-performing utilities in the United States is to adjust of the authorized rate of return. It sends a signal to the investors who, in turn, may vote their confidence in the utility operation by divesting their investment. A similar approach can be used in Georgia. The current GNERC ratemaking procedures are based on the cost recovery of reasonable expenses plus the regulatory established rate of return on assets. Making a downward adjustment could be a simple and effective action on the regulatory side. This adjustment can be done during the periodic (annual) or ad hoc (Commission-initiated) rate review and is entirely within the Commission's power. There is, however, one exception. The rates currently established in Georgia are the result of a less than transparent process. They are developed in a negotiation process where the final results are presented with key factors being commingled and buried in the analysis. Therefore, the announcement of downward rate of return adjustment for lack of regulatory compliance should be advertised by the Commission and increase its deterrent effect.⁷

Disallowance of imprudent expenditures. GNERC may also disallow certain costs incurred by a licensee on activities later found by the regulators to be imprudent. In order to make a disallowance (or a general cost analysis), a detailed cost of service study prepared according to acceptable accounting practices is required. Currently, audited cost of service studies are not being performed in Georgia. Similarly to the rate of return adjustment, it is necessary to inform other licensees of the decision to disallow imprudent costs.

⁷ We note that this remedy will only work on distribution enterprises that have been privatized, and whose owners have an incentive to maximize revenues. State-owned distribution licensees currently care so little about revenues that their rates of collection from customers are abysmally low, which is why the government is privatizing these assets.

Change in the structure of penalties.

It would be ideal if the Commission could impose the monetary penalties without the necessity of involving other authorities and participating in a lengthy administrative process. But even in this case there can be further improvement to the procedures for imposition of monetary penalties.

First, rather than penalizing a company for regulatory non-compliance, a specific penalty might be assessed against the members of the senior management responsible for the operation of the company. A penalty that seems to be low or acceptable for a company as a whole may prove to be a substantial financial inconvenience for the individuals and encourage them to comply with decisions of the Commission. Another way of imposing penalties is to structure them so that the penalty is imposed on a daily basis. The total penalty for a violation will equal to the penalty per day multiplied by the number of days the violation took place. Such a penalty structure would allow the regulator to:

- impose the penalty that is proportional to the committed violation
- send a signal to potential violators that there is no ceiling on the penalty imposed

A schedule of unit penalties per day should be developed and the Commission, rather than the courts, should be given the authority to impose the monetary penalties. What remains unresolved is the issue of the ability or willingness of the violator to pay the fine; in such cases, it may become necessary to refer the case to the criminal court. Finally, introduction of this type of penalty will have to be done through the modification to the Code of Administrative Violations.

Yet another improvement can be made regarding the level of a one-time penalties. Currently, the violator will either have to pay a relatively small fine or, on the other end, lose a license. There is nothing in between in case when either of the extreme penalties seems to be appropriate. We recommend that the upper limit of the penalty range be increased. As with the recommendation on penalties based on the number of days of violations, it will have to be done through the modification to the Code of Administrative Violations.

Conclusion

GNERC may substantially improve and clarify its enforcement program by adopting the foregoing recommendations. Amendments to the Code of Administrative Violations will enhance the Commission's ability to enforce the Law on Electricity and Natural Gas and its rules and regulations.

ATTACHMENT 1

EXCERPTS FROM THE CODE OF ADMINISTRATIVE VIOLATIONS

Attachment

Excerpts from the Code of Administrative Violations

Clause 92. Inefficient Use of Electric and Thermal Energy

Inefficient use of electric and thermal energy i.e. regular inefficient or idle functioning of electric stoves and other electric and thermal equipment, direct losses of compressed air, water and heat caused by improper operation of pipelines, pipeline insulation, stoves and other equipment working on thermal power, use of electric power for heating purposes of office space and other premises, as well as for the non-operational purposes is penalized from 200 to 500 Lari. The companies engaged in wasteful use of electric power for lighting or theft of electricity regardless of the form of theft will be penalized in the amount of 200 to 500 Lari.

Clause 92¹. Violations of Requirements Set by the Commission

Noncompliance of the licensee of the energy sector or the customer with the regulations set by the Commission shall be penalized by the amount of minimum salary multiplied by 30 to 300.

Clause 93. Damage of the Electric Network up to the Voltage of 1000 V

Damage caused to transmission lines up to 1000 V (overhead, underground and underwater transmission lines, distribution equipment) resulting in interruptions in the electricity supply to customers and losses national economy will be penalized as follows: for individuals - warning or penalty in the amount of minimum salary multiplied by 10 to 50; for authorities - minimum salary multiplied by 50 to 100.

Clause 94. Violation of Security Rules for the Electric Network Higher then 1000 V

Violation of security rules for the electric network higher then 1000 V set by the Cabinet of Ministers of Georgia that caused or might cause interruptions in the electricity supply to customers, damage of electric network or other losses to national economy will be penalized as follows: for individuals - warning or penalty in the amount of minimum salary multiplied by 10 to 50; for authorities- minimum salary multiplied by 50 to 100.

Clause 96¹. Violation of the Rules for Use of Energy Resources

Violation of rules of use of electric or thermal energy, gas, oil or oil products, or theft of energy resources regardless of the form of theft that has not caused considerable losses will result in penalty from 100-200 Lari. Same violations on the main pipelines will be penalized in the amount from 200 to 500 Lari.

Clause 208. Regional (City) Courts (Lawyers, Administrative Judges)

Regional (city) courts (judges, administrative judges) consider cases of administrative violations described in Clauses 45, 46, 47-102, 103-105, first part of Clause 120, Clauses 134-139, 141, 142, 143-154, 156, 158, 164, 165, 166, 167, 170, 171 (3), 173 (3-8), 178, 174, 175, 176, 177, 179, 180-187, 195, 196, and 197.

Clause 239. Protocol of Administrative Violations

1. The authorized management member or the representative of public organization makes protocol on administrative violations. Protocol is not required in the cases described in the Clause 242.
2. Protocol on administrative violations described in Clauses 57, 90, 91, 95, 96, 125, 173 is made by the state technical supervisory bodies.
3. The bodies of forest economy and environment shall make protocol on administrative violations.
4. Protocol on administrative violations described in Clauses 51¹, 53¹, 55⁴, 62-63, 85, 86 is made by the authorities responsible for the protection national parks and preserved territories.
5. Protocol on administrative violations described in Clauses 86, 48, 49, 57, 60, 62-65, 41-75, 85, 89 is made by bodies of internal affairs (ecological police).
6. State supervisory bodies of history and culture preservation shall prepare protocol on administrative violations described in Clause 88.
7. Protocol on administrative violations described in Clause 92¹ shall be prepared by the Georgian National Energy Regulatory Commission.
8. The authorized persons of gas industry within their competence shall prepare protocol on administrative violations described in Clauses 95 and 961.

9. The authorities of police, railway, marine and river transport shall prepare protocol on administrative violations described in Clause 1071.
10. Authorities observing the compliance with the rules of subway use shall prepare protocol on administrative violations described in Clauses 1072 and 1073.
11. Protocol on administrative violations described in Clauses 116, 126, 133, 136, 137, 177¹ shall be prepared by bodies of internal affairs (traffic police).
12. The persons authorized by local governmental bodies shall prepare protocol on administrative violations described in Clauses 145 and 152.
13. Protocol on administrative violations described in Clause 152 shall be prepared by authorized specialists of the institutes of construction mechanics and seismic stability of the Academy of Sciences of Georgia.
14. Protocol on administrative violations described in Clauses 153, 154, 158, 163, 165, 159, 178 shall be prepared by the bodies of internal affairs or persons authorized by the bodies of public administration, tax authorities, persons authorized by the Chamber of Control or State Antimonopoly Service.
15. Protocol on administrative violations described in Clauses 164 and 165 shall be prepared by state tax authorities.
16. Protocol on administrative violations described in the clauses 174, 174, 174 shall be prepared by Central Election Commission.

Clause 240. Contents of the Protocol of Administrative Violations

Protocol of Administrative Violations shall contain: place and date of protocol, position and name of the person preparing the protocol, information about the suspect; place, time and nature of the administrative violation, normative act prescribing penalties for the violation, names and addresses of witnesses and victims (if they exist), explanation of the suspect, and other information necessary to resolve the case.

Protocol is signed by the person preparing it and the suspect; if witnesses and victims exist, they also shall sign the protocol.

If the suspect refuses to sign the protocol, corresponding notice is included in the protocol. The suspect has a right to present explanatory letter and remarks regarding the contents of the

protocol as well as to formulate reasons for refusing from signing the protocol, which shall be attached to the protocol.

In the process of composing the protocol, the suspect is notified about his rights and obligations described in the Clause 252 of the present Code and this fact is recorded in the protocol.